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Publication Date
2022-12-22

Peer reviewed

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Forthcoming: Academy of Management Annual Meeting Proceedings, 2020

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ABSTRACT

In this paper, we extend the BTOF to nonprofit organizations. Nonprofits hold both financial and higher-priority nonfinancial programmatic performance goals that relate to program spending directed to fulfill a social mission. We hypothesize that, while financial performance above aspirations decreases fundraising, programmatic performance above aspirations increases fundraising efforts. We also theorize that board size, environmental munificence, and program-generated revenue influence the extent of fundraising as a response to attainment discrepancies. We test our hypotheses using a panel dataset of 12,382 U.S. nonprofits and find support for several of our predictions.

INTRODUCTION

Scholars in the Behavioral Theory of the Firm (BTOF) tradition have long-established distinctive organizational behaviors as a response to patterns of success or failure in their performance (Cyert and March, 1963; March and Simon, 1958). A simple interpretation of BTOF predicts that when performance falls below aspirations (failure), organizations engage in problemistic search for ways to raise performance above the aspiration level (Bromiley, 2004). Conversely, firms interpret performance exceeding aspirations as success, which in turn, depresses search.

Although Cyert and March (1963) center their work on business firms, March and Simon (1958) address organizations in general suggesting similar decision-making mechanisms appear in a variety of organizations. However, previous literature has paid little attention to non-business organizations, and almost none to nonprofits. Thus, whether the predictions of the BTOF hold for nonprofits remains an open question. To answer this question, we develop a theory of search in nonprofit organizations. Our theory builds on the established principle that performance relative to aspirations –henceforth attainment discrepancy (AD)– drives search (Cyert & March, 1963). However, we propose that nonprofits set aspirations in both financial and nonfinancial dimensions. Nonfinancial aspirations relate to goals requiring program spending, what we term *programmatic aspirations*. Given the differences between financial and programmatic aspirations, we expect that attainment discrepancies in each dimension influence search differently.

We test our theory on a specific dimension of problemistic search for nonprofits, namely fundraising efforts. Fundraising is a key mechanism by which nonprofits search for sources to secure their financial viability (Brooks, 2004). In line with the BTOF, we expect that performance above financial aspirations–positive financial AD–decreases fundraising efforts, while financial performance below aspirations–negative financial AD–increases fundraising efforts. In contrast, positive programmatic AD increases fundraising efforts, as managers search for ways to fund the increased activity. Nonprofits need to search for funding options since they operate in a context where demand and revenues often have little connection. The individuals and processes that provide resources to nonprofits often differ significantly from those benefiting from the nonprofits.

Programmatic success should trigger fundraising efforts, since current resources may not suffice to meet increased demands. Conversely, negative programmatic AD should reduce fundraising.

Additionally, we explore factors that moderate the relations between programmatic AD and fundraising outlays. On the one hand, we expect that the organization's ability to charge fees negatively moderates the search-inducing effect of positive programmatic AD. Fee-charging nonprofits can connect demand and revenues more closely by requesting payments, reducing their dependency on external funding. On the other hand, we expect the effect of programmatic performance on search either increases (above aspirations) or decreases *less* (below aspirations) when search uncertainty decreases or the expected value of reward increases (March and Simon, 1958). This is the case for nonprofits with large boards and operating in munificent environments.

We test these relations with an unbalanced panel dataset consisting of 12,382 U.S. nonprofits, finding support for several of our predictions. Our paper makes three contributions. First, we extend the BTOF to develop a theory of search for nonprofit organizations. Theoretically, this gap represents a shortcoming since part of the BTOF (c.f., March and Simon, 1958) addressed organizations in general, not only of business firms (Cyert and March, 1963; March, 1981). Second, our study explores how both internal factors and environmental conditions moderate the influence of performance relative to programmatic aspirations on nonprofit search. Third, our study contributes to strategy research by developing a behavioral perspective of a critical managerial decision, namely the level of fundraising spending.

THEORETICAL FRAMEWORK AND HYPOTHESES

March and Simon (1958) offers a theory of organizations, not just businesses. However, few scholarly studies have extended BTOF research to nonprofit organizations. This omission is surprising: the U.S. has over 1.56 million registered nonprofits accounting for 10.2 percent of all wages paid during 2016, and representing 5.4 percent of the total GDP. From a theoretical standpoint, nonprofit organizations offer a fertile setting for extending work in BTOF, explaining how organizations respond to performance feedback from multiple goals (Greve and Gaba, 2017). By design, nonprofits incorporate both financial and nonfinancial goals; the nonfinancial goals relate to investment in programs and services that respond to the demands of the local. In the next sections, we theoretically disentangle financial and (nonfinancial) programmatic aspirations as they develop in nonprofits, and theorize about the influence of AD in each dimension on search through fundraising, which represents a key strategic response to deal with income uncertainties.

Financial Attainment Discrepancy and Fundraising in Nonprofits

Financial performance that meets or exceeds current aspiration levels tends to make decision-makers satisfied with current strategies, thus reducing incentives for search (Cyert & March, 1963). Although performance above aspirations may also trigger other ways of search, such as slack search in innovation-intensive contexts (Levinthal and March, 1981; Zahra, 2005), slack search may be relatively rare in nonprofits as most operate in contexts with severe resource constraints (Ellen and Voicu, 2006). Nonprofits typically occupy a disadvantaged position in terms of accessing the necessary funding to provide services and to respond to local needs. Therefore, stabilizing cash flow and controlling costs are fundamental pillars of most nonprofits' strategies.

Resource scarcity makes nonprofit decision-makers wary of excessive fundraising expenditures. While fundraising expenditures may raise future income, they incur immediate costs and require limited management time that strains the organization. Furthermore, fundraising efforts have uncertain outcomes. While fundraising generally raises revenue (Chikoto and Neely, 2013), its effectiveness depends on how the organization manages fundraising and the nonprofit's environment (Das, Kerkhof, and Kuiper, 2008). Furthermore, excessive fundraising may convince current and potential donors that the nonprofit focuses on funding rather than service delivery. Thus, fundraising has unforeseeable outcomes and potential liabilities.

Given these characteristics of fundraising, aspirations theory would predict that fundraising outlays should decrease when the nonprofit's financial performance exceeds aspiration levels. Success depresses search (Cyert and March, 1963; March, 1994), and the successful acquisition of financial resources should lead the organization to decrease fundraising expenditures. Therefore,

> ***Hypothesis 1a*** *(H1a): Positive financial AD will negatively influence fundraising expenditures.*

In contrast, financial performance below aspiration levels will trigger a search for ways to improve funding. This follows the substantial majority of research on AD where financial performance below aspirations stimulates efforts to improve financial performance. With a decline in financial performance, a nonprofit cannot provide the quality and quantity of services the clients have come to rely on. Consequently, low financial performance relative to aspiration levels (i.e., large negative values for AD) will stimulate a nonprofit to increase fundraising efforts.

> ***Hypothesis 1b*** *(H1b): Negative financial AD will negatively influence fundraising expenditures.*

Programmatic Aspirations and Expansion-driven Fundraising

In addition to financial aspirations, nonprofit managers also consider programmatic aspirations. While nonprofits may define programmatic aspirations in terms of direct services (e.g., individuals helped), such aspirations translate directly into program spending targets needed to fund such activities. Indeed, while generating revenues may be a primary objective of for-profit firms, almost all nonprofits exist primarily to provide services – the generation of resources constitutes a necessary condition to provide the services rather than a value *per se*.

Programmatic success generally increases the need for funds. Such success often reflects a winning initiative or a desire to expand current offerings. However, programmatic performance poses a challenge for decision-makers. While high programmatic performance may indicate growth in the demand for nonprofits' programs and services, meeting that increased demand requires nonprofits search for funding to support higher program spending. Because nonprofits have a disconnect between investment in social goals and revenue, nonfinancial (programmatic) success often increases (rather than decreases) search through fundraising.

Programmatic success also increases the expected returns from fundraising. High demand for a nonprofit's services legitimizes the organization's mission (DiMaggio and Anheier, 1990), often increasing the organization's visibility, thus increasing managerial confidence in the outcomes of fundraising endeavors. In times of programmatic success, managers may deem fundraising as less uncertain and with higher expected returns. Hence,

> ***Hypothesis 2a*** *(H2a): Positive AD discrepancy will positively influence fundraising expenditures.*

Mirror arguments apply when programs decline. Lower demand for the organization's services reduces the pressure to find funds. Also, negative programmatic AD lessens the ability of the organization to showcase information about social achievements to donors, increasing the likelihood that donations will not exceed the cost of fundraising. Overall, declines in program services are expected to reduce fundraising expenditures. Therefore,

> ***Hypothesis 2b*** *(H2b)**:** Negative programmatic AD will positively influence fundraising expenditures.*

Uncertainty-reducing Factors and Nonprofit Search

The influence of AD on search depends on both organizational factors (Joseph, Klingebiel, and Wilson, 2016) and environmental conditions (March and Simon, 1958). Therefore, we consider how features of both the nonprofit and the local community in which it operates moderate the relation between programmatic performance and fundraising.

Fee-charging Nonprofit Organizations. Whereas nonprofits that fund programs only from donations must increase fundraising to cover the full cost of any increase in services, nonprofits with a fee-for-service model only need to cover a part of such costs from donations, thus reducing the gap between demand and revenues. Nonprofits that manage to derive higher commercial revenues from their activities will need to expend less on fundraising when facing higher demand than other organizations without such revenues. For these reasons, we anticipate that these nonprofits will resort less intensely to fundraising as a response to positive programmatic AD.

> ***Hypothesis 3a*** *(H3a): Commercial revenues will negatively moderate the positive influence of positive programmatic AD on fundraising expenditures (i.e., reduce the extent of the increase in fundraising expenditures).*

Again, a mirror argument applies to nonprofits facing a decline in demand for their services. In nonprofits that charge fees, a reduction in program demand results in a reduction in fee revenue. Consequently, a decrease in program demand creates higher financial pressure in nonprofits dependent on fee revenue than in nonprofits utterly dependent on donations or external funding.

> ***Hypothesis 3b*** *(H3b): Commercial revenues will positively moderate the negative influence of negative programmatic AD on fundraising expenditures (i.e., reduce the extent of the decrease in fundraising expenditures).*

Board size. The board's ability to help in fundraising both reduces this uncertainty and increases the expected returns from fundraising efforts. Features that lower the uncertainty of search and raise expectations of positive outcomes should intensify search efforts (March, 1994). A salient feature of nonprofits' boards is their size. In nonprofits with larger boards, the board can spread the work of monitoring and control across a higher number of participants, thus leading to a greater focus on the details of daily operations (Brown, Andersson, and Jo, 2016). Also, a larger board increases governance quality (Miller, 2002), reducing concerns regarding the use of donations to fund programs. Board members often act in consert with management to aid fundraising, so board size directly helps in fundraising. Since larger boards in nonprofits mitigate uncertainty and increase expected returns, we expect that,

> ***Hypothesis 4a*** *(H4a): Board size will positively moderate the positive influence of positive programmatic AD on fundraising expenditures (i.e., amplify the extent of the increase in fundraising expenditures).*

If board size lowers the difficulty of raising funds and increases the expected revenue from such efforts, it should tend to offset any tendency to decrease fundraising in the face of negative programmatic AD. In other words, while fundraising efforts may decline with low program performance (as per H2b), they would decline less in organizations where fundraising is relatively easy (i.e., nonprofits with larger boards).

> ***Hypothesis 4b*** *(H4b): Board size will negatively moderate the negative influence of negative programmatic AD on fundraising expenditures (i.e., reduce the extent of the decrease in fundraising expenditures).*

Environmental Munificence. BTOF scholars have noted the richness of the external environment influences search efforts (March, 1994; Nadkarni and Barr, 2008). Consequently, management's perception of the likelihood the environment holds beneficial options should increase the propensity of managers to search for such options. In deciding to spend funds on fundraising, managers consider the likely returns to such expenditures. Fundraising inherently involves efforts to have individuals and organizations in the nonprofit's environment donate funds or other valuable items. Disposable income positively influences charitable giving (Auten, Sieg, and Clotfelter, 2002). Operating in a richer, more munificent environment should increase the perceived returns on fundraising, leading managers in nonprofits with positive programmatic performance AD to increase expenditures to fund its programs.

> **Hypothesis 5a** (H5a): *Environmental munificence will positively moderate the positive influence of positive programmatic AD on fundraising expenditures.*

On the other hand, if environmental munificence lowers the difficulty of raising funds and increases the expected revenue from such efforts, it should also offset any tendency to decrease fundraising in the face of low program performance relative to aspirations. Thus, we expect

> **Hypothesis 5b** (H5b): *Environmental munificence will negatively moderate the negative influence of negative programmatic AD on fundraising expenditures.*

METHODS

Data. We created an unbalanced panel dataset consisting of 12,382 nonprofit organizations operating in 376 urban regions of the US from 2002 to 2013.

Measures. *Dependent variable.* Total unscaled fundraising expenditures for the fiscal year.

Independent variables. Using historical aspiration levels, our final measures are calculated as follows. *Financial AD* is calculated using total revenues in year t-1 minus the previous year's revenues (t-2) (Harris and Bromiley, 2007). *Positive Financial AD* ($p - a >= 0$) equaled (total revenues $_{t-1}$ – total revenues $_{t-2}$) if total revenues $_{t-1}$ >= total revenues $_{t-2}$, and 0 otherwise. *Negative Financial AD* ($p - a < 0$) equaled (total revenues $_{t-1}$ – total revenues $_{t-2}$) if total revenues $_{t-1}$ < total revenues $_{t-2}$, and 0 otherwise. We calculated *positive programmatic AD* and *negative programmatic AD* analogously, using total program expenditures.

Moderator variables. Commercial revenues equals the total revenues the nonprofit obtained from the direct sale of their products and services. *Board size* equals the total number of voting members. Finally, *environmental munificence* equals the total GDP of the local community on which the nonprofit organization operates.

Control variables. Our models include several control variables that influence the levels of fundraising in a nonprofit, such as *overhead spending, previous fundraising, and size.*

Analysis. We corrected for endogeneity of the lagged DV by employing a 2SLS FE regression.

RESULTS AND CONCLUSIONS

Our results show that positive programmatic AD increases fundraising and that positive financial AD diminishes it. Board size and environmental munificence increase the positive effect of positive programmatic AD on fundraising and commercial revenues decrease it. Negative programmatic AD, reduces fundraising only when the nonprofit has low commercial revenues. However, it increases fundraising when nonprofits have higher commercial revenues, larger boards, and operate in a less munificent environment. Together, these results show that the link between programmatic AD and fundraising efforts depends on three key strategic components: i) the business model of the organization (fee-charging vs. donation-based), ii) the governance structure (board size), and iii) the local context where nonprofits operate.

In extending BTOF analysis to nonprofit organizations, we find several interesting behavioral differences from for-profit organizations. For example, in nonprofit organizations, financial performance both above and below aspirations reduces problemistic search (though more strongly in the former). Also, and most notably, nonprofit organizations increase fundraising as the organization moves forward to its primary social goal (i.e., programmatic targets). This dynamic differs from most analyses in for-profit firms. In general, success in a primary goal depresses search, making decision-makers satisfied with current strategies (Bromiley, 2004; March, 1994). We observe the opposite behavior in nonprofits: succeeding in the primary social goal increases willingness to engage in uncertain search activities such as fundraising. These findings suggest that search through fundraising in nonprofits depends on an intricate web of multiple goals and various contingencies.

REFERENCES AVAILABLE FROM THE AUTHORS